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REPORT TO THE CONGRESS



BY THE COMPTROLLER GENERAL
OF THE UNITED STATES

UNITED STATES
GENERAL ACCOUNTING OFFICE

MAR 11 1976



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Second GAO Report On Need For Better Control Over Government-Furnished Material Provided To Defense Overhaul And Repair Contractors

Department of the Air Force AGC00035
Defense Supply Agency AGC00107

Air Force overhaul and repair contractors are given about \$200 million of Government material every year. The Air Force, however, does not have the necessary records to hold the contractors accountable for this material.

GAO found one case involving the apparent misuse of Government-furnished material valued at about \$2.5 million. Good business practice dictates that when custody of property is transferred from one supplier to another, an audit trail of what was transferred must be kept by the supplier to provide accountability.

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MARCH 8, 1976



COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-140389

CWO 00001

To the President of the Senate and the
Speaker of the House of Representatives

This report identifies ways to improve controls over Government-furnished material held by overhaul and repair contractors.

Our review was made pursuant to the Budget and Accounting Act, 1921 (31 U.S.C. 53), and the Accounting and Auditing Act of 1950 (31 U.S.C. 67).

We are sending copies of this report to the Director, Office of Management and Budget; the Secretary of Defense; and the Secretaries of the Navy and Air Force.

Frederic A. Atch

Comptroller General
of the United States

C o n t e n t s

		<u>Page</u>
DIGEST		i
CHAPTER		
1	INTRODUCTION	1
2	NEED TO IMPROVE CONTROLS OVER GOVERNMENT-FURNISHED MATERIALS HELD BY OVERHAUL AND REPAIR CONTRACTORS Sacramento Air Logistics Center	2 3
3	EFFORTS TO IMPROVE MANAGEMENT OF GOVERNMENT-FURNISHED MATERIAL Navy's single supply support con- trol point Prior GAO report DOD report	6 6 6 7
4	CONCLUSIONS, RECOMMENDATIONS, AGENCY COMMENTS, AND OUR EVALUATION Conclusions Recommendations to the Secretary of Defense Agency comments and our evaluation	8 8 8 9
5	SCOPE OF REVIEW	10
APPENDIX		
I	Comments from the Department of Defense	11
II	Principal officials of the Departments of Defense and Air Force and Defense Supply Agency responsible for adminis- tering activities discussed in this report	19

ABBREVIATIONS

ASPR	Armed Services Procurement Regulation
DCAS	Defense Contract Administration Services
DOD	Department of Defense
GAO	General Accounting Office

COMPTROLLER GENERAL'S
REPORT TO THE CONGRESS

SECOND GAO REPORT ON NEED FOR
BETTER CONTROL OVER GOVERNMENT-
FURNISHED MATERIAL PROVIDED TO
DEFENSE OVERHAUL AND REPAIR
CONTRACTORS

Department of the Air Force
Defense Supply Agency

AGC 6-235
AGC 63107

D I G E S T

Contractors which do overhaul and repair work for the Air Force are given about \$200 million of Government material each year. As long ago as 1970, GAO recommended improvements in the management of Government materials given to contractors. Generally, the military services agreed and said corrective action was being taken.

AGC 6-235
However, a February 7, 1974, internal Department of Defense audit report stated little, if any, management attention was being paid to the control of Government-furnished material in contractors' plants. The audit report's conclusion, in part, was based on the following.

--Government property administrators were not using material requirements lists to evaluate the reasonableness of Government material used.

--Contract administration procedures and practices were not adequate to insure the use of only minimum amounts of Government material.

--Contractor inventories were not watched to make sure that stockage levels were reasonable and that excess material was identified.

7/C
GAO found one case involving the apparent misuse of Government-furnished material valued at about \$2.5 million. GAO also reviewed current Air Force procedures and controls at four Air Force Logistics Centers to determine what safeguards are needed to protect the Government's interests.

The four Air Logistics Centers are

Oklahoma City, Oklahoma;
Ogden, Utah;
Sacramento, California; and
San Antonio, Texas.

GAO found accountability for Government-furnished material within the Air Force includes such weaknesses as

- incomplete estimates of materials to be used,
- limited knowledge of materials ordered and received by contractors, and
- inadequate checks of whether materials are used for proper purposes.

For example:

- Air Force contractors ordered Government materials directly from Government supply systems and received direct shipments with little or no Air Force surveillance. (See p. 3.)
- There was no established way to find out from Government sources amounts of materials ordered and received by contractors. Government property administrators could not determine receipt of Government material unless contractors kept records of the receipts. (See p. 3.)
- Contractors' consumption of Government material could not be compared against expected or planned use rates, because the material requirements lists provided by the Air Force to contractors were incomplete and/or inadequate. (See p. 2.)
- Reliable determinations of contractors' performance were further complicated, because some contractors worked on similar Government and commercial items at the same plants. (See p. 5.)

Good business practice dictates that when custody of property is transferred from one supplier to another, an audit trail of what was transferred must be kept by the supplier to provide accountability. These practices are common in private industry and have equal application to property transfers between the Government and its contractors.

Although the Department of Defense stated that current efforts by a joint Air Force and Defense Supply Agency's Contract Administration Services task force make it unnecessary for the Department to provide any additional direction, GAO believes (see p.8) that to insure the success of its efforts to improve the accountability for Government-furnished material the task force should be instructed to:

- 1) --Develop procedures within the Air Force accounting system that establish an audit trail for determining the amount of Government material given to contractors. This will permit comparisons between what Government activities report as furnished to contractors and what contractors report as received. In those instances where differences exist, reconciliations should be required.
- 2) --Design better consumption data to improve the evaluation of contractors' reported usage of Government material and identify excess material held by contractors.
- 3) --Provide this information to property administrators so they have independent data that can be used to pinpoint differences between the Government and contractors' records.
- 4) --Provide guidance to property administrators on the need for increased surveillance when the contractor is doing commercial and Government work at the same location.

CHAPTER 1

INTRODUCTION

The Air Force awards contracts for the overhaul and repair of various equipment, such as aircraft, aircraft engines, and components. The contracts are usually awarded by the five Air Logistics Centers and administered by the Defense Supply Agency's Contract Administration Services (DCAS).

The Air Force gives about \$200 million of Government material to the contractors every year for use under the contracts. The material includes parts, components, assemblies, raw and processed materials, and supplies that are attached to or incorporated into end items delivered under the contract.

Contractors are required to manage all Government-furnished material in their possession in accordance with procedures set forth in the Armed Services Procurement Regulation (ASPR). Under the procedures of ASPR, contractors are required to establish and maintain a system to control, protect, and preserve Government property. These systems are subject to review and approval by the Government's property administrators.

Government policy is to rely on contractors' property control records. That policy designates the contractors' books as the official contract records. Contractors are supposed to keep adequate accounts for all Government material provided under a contract. The official records (the contractors' books) are to be kept in such condition that, at any stage of work, the status of Government property may be readily ascertained.

Government property administrators are supposed to make a complete survey of the contractors' accounting systems for property control at least once each calendar year. Minor problems disclosed by their surveys can be resolved informally but major problems are to be brought to the attention of the administrative contracting officer and the purchasing office for resolution.

CHAPTER 2

NEED TO IMPROVE CONTROLS OVER GOVERNMENT-FURNISHED MATERIALS HELD BY OVERHAUL AND REPAIR CONTRACTORS

Good business practice dictates that when custody of Government property is transferred to contractors, the Government to insure accountability must maintain evidence of what is turned over. Estimates of how much material should be used to carry out the contract are also a basis for evaluating the contractors' use of Government assets.

The Air Force relies on records kept by the contractors which have physical custody of Government material. The Air Force does not have its own audit trail 1/ for verifying the amount of material turned over to the contractors. Furthermore, the Air Force does not have an accurate estimate of how much Government material contractors should use.

The DCAS property administrators are faced with the same limitations as the Air Force--the only records for determining the amount of Government material received by the contractors are the contractors' records. Furthermore, DCAS officials told us that the only means of determining the reasonableness of Government material used was to compare contractor usage against material requirements lists. The material requirements lists are used to forecast the amount of Government material needed to overhaul a single unit. These lists are constantly revised and, at best, are gross estimates of parts required for overhaul work.

Problems in managing Government material held by contractors are not new. We reported similar findings to the Department of Defense (DOD) in 1970 (see p. 6), and more recently, DOD auditors reported this matter in February 1974. (See p. 7.)

During our review at one contractor location, we found apparent misuse of Government-furnished material valued at about \$2.5 million and referred the case to the Department of Justice for investigation. We also reviewed the management of Government-furnished material at four Air Logistics Centers. Our findings at Sacramento Air Logistics Center

1/An audit trail is a record that permits identification of Government materials given individual contractors.

are outlined below. Similar conditions were found at the other three centers.

SACRAMENTO AIR LOGISTICS CENTER

Controls over Government material at the Sacramento Air Logistics Center are designed to detect gross mismanagement and establish reasonable limits on the quantity of materials provided to contractors. The reasonableness of contractors' Government material stock levels and use rates is based on the material requirements lists prepared by Center personnel before the contract award. The lists are updated by the contractor during contract performance. However, Center personnel told us that the lists were merely rough estimates of material expected to be used and were rarely accurate.

Contractors working for the Center request and receive material directly from Government supply sources. The requisitions are not required to be reviewed or approved by any Government representative. Further there is no current procedure at the Center that establishes an audit trail showing the amount of Government material turned over to contractors. Center personnel depend on the assigned property administrator to insure that the contractor is properly reporting the receipt and use of Government material. The administrator, however, cannot determine whether a contractor received an item unless the contractor keeps records of the receipts. This is because the administrator does not receive material shipping information from the Government shipping source to compare against the contractors' record of receipts.

We visited the DCAS office in Burlingame, California, and reviewed the workpapers for three of the contracts managed at the Sacramento Air Logistics Center. The property administrators' workpapers showed that a thorough analysis of the contractors' records and a physical count of the Government material had been made. However, we found no evidence that the administrators had made a physical examination to see that material was used for proper purposes. Similarly, we found no evidence that the amount of material used was reasonable based on the number of units completed by the contractor.

Neither the physical observation of material used nor the determination of the reasonableness of such use are normal survey steps, according to DCAS officials. In commenting on this, (see app. I, p. 14), DCAS stated there was a misinterpretation of the actual situation. DCAS pointed out that ASPR specifies that property administrators are required

to determine the reasonableness of Government material used. DCAS did admit, however, that the only way property administrators can determine such reasonableness was to compare usage against a constantly revised material requirements list.

We agree ASPR specifies that property administrators are supposed to take such steps. However, we were referring to what was actually done and not to what was supposed to have been done. In this regard, DOD auditors stated that the primary weakness observed during their audit was the failure of property administrators to use the material requirements lists to evaluate reasonableness of Government material used.

Government-furnished materials given to contractors consist of two categories--expense items and repairable or reusable items called investment items. Expense items are generally of low value; i.e., nuts, bolts, wiring, and tubing. Investment items are generally more costly.

There were 81 active overhaul and repair contracts managed at the Sacramento Air Logistics Center as of September 1974. DOD instructions require the services to estimate the cost, including Government materials, of overhaul and repair work before awarding the contract. Accordingly, the Center estimated the dollar value of the 81 contracts as follows:

	(millions)
Contractor labor and material	\$59.6
Government-furnished material (expense items only)	<u>13.6</u>
Total	<u>\$73.2</u>

The Center had an audit trail showing a total dollar figure of \$13.8 million for the low-value, nonreusable expense items given to contractors, but it did not include details as to the quantity or description of these items. Further, monthly reports from the contractors showed a total of \$20.3 million of expense items as compared to the \$13.8 million shown by the Center. The difference of \$6.5 million could not be reconciled because Air Force records were not available.

The Center did not have an audit trail for verifying the amount or kinds of more expensive and reusable investment items given to its contractors. Contractors reported receipt of \$17.6 million of Government-furnished investment items for the 81 contracts. The Center had no means of verifying the accuracy of these reports.

This lack of an Air Force audit trail for verifying the amount of Government material turned over to contractors results in the property administrator having no means of insuring that all material shipped to contractors was received and properly accounted for. The administrator's task is also hampered because the material requirements lists are not adequate to evaluate the contractors' use of Government material.

The situation is further complicated because contractors overhauling and repairing Government equipment sometimes do the same work for private companies. Out of the 81 active contracts managed by the Sacramento Center, we noted that 53 contractors were involved in commercial work; 46 in the same plant where Government work was being done and 7 in other plants. In such situations we believe that it is particularly important that adequate accountability for Government-furnished material be maintained.

CHAPTER 3

EFFORTS TO IMPROVE MANAGEMENT OF GOVERNMENT-FURNISHED MATERIAL

Accountability for Government-furnished material has been a problem for a long time, and both GAO and DOD have previously reported on it. During our current review, we noted that the Navy and Air Force systems for managing Government-furnished material are different.

We did not review the Navy system in detail. We did, however, note that DOD auditors had indicated the Navy system, while requiring further refinement, had resulted in cancellation or reduction of contractor-submitted requisitions totaling \$529,000 during 1972. We are not suggesting that the Navy system be adopted by the other services. It is, however, another way Government-furnished material is managed.

NAVY'S SINGLE SUPPLY SUPPORT CONTROL POINT

Before 1967 contractors doing overhaul and rework for the Naval Air Systems Command requisitioned Government material directly from supply activities or purchased material from commercial sources--the same procedures currently followed by Air Force contractors. The Navy recognized that this system lacked a monitoring agency and established a program manager to serve as the point of contact between the contractor and the supply system.

Under the Navy concept, contractor requisitions for Government material and requests for local purchases on each rework program are sent directly to a Navy program manager. The manager screens the contractor's requests to insure that the requests are valid. To aid in the review process, the program manager keeps a complete file of contractor requisitions and confirmed receipts and requires the contractor to submit quarterly reports of material usage and on-hand balances for each item in stock. The program managers can use these records to determine the total amount of Government material furnished to contractors and to evaluate the reasonableness of material used.

PRIOR GAO REPORT

In our report B-140389 dated June 17, 1970, we advised the Secretary of Defense that inadequate administration of Government property by contractors and military services had

resulted in (1) unnecessary investment in inventory, (2) increased transportation costs, (3) possible unnecessary procurement, and (4) potential shortages at some locations. One of the underlying causes of the deficiencies was inadequate surveillance of contractors' performance by responsible property administrators. Generally, the military services agreed with our findings and said corrective action was being taken.

DOD REPORT

A February 7, 1974, internal DOD audit report covering the controls of Government-furnished material for several major DOD contractors stated little, if any, management attention was being paid to the control of such material in contractors' plants. The report's conclusion was, in part, based on the following:

1. Property administrators were not using material requirements lists to evaluate the reasonableness of Government material used.
2. Contract administration procedures and practices were not adequate to insure using only minimum amounts of Government material.
3. Contractor inventories were not monitored to make sure that stockage levels were reasonable and that excess material was promptly identified.

CHAPTER 4

CONCLUSIONS, RECOMMENDATIONS,

AGENCY COMMENTS, AND OUR EVALUATION

CONCLUSIONS

When the records of materials given to contractors are kept by contractors which also have physical custody of these materials, we believe minimum acceptable control would require a way for Government representatives to verify contractor reports of materials received, used, and remaining in inventory. Independent verification and evaluation would require:

1. A Government record by national stock number, quantity, and dollar value of the Government material given individual contractors. This could be done by furnishing Government property administrators with information on Government material shipped to contractors.
2. Periodic verification of the accuracy of contractors' records by testing them with the Government's records of material shipped to the contractors and auditing contractors' usage reports. In addition, the practice of taking physical inventories of materials on hand should be continued.
3. Preparation of better estimates of expected usage of Government-furnished material. This includes periodic evaluation of the reasonableness of such estimates and appropriate adjustments when necessary.

DOD has advised us that a joint Air Force/DCAS task force is studying the problems of controlling Government-furnished material and therefore it feels additional directions to those agencies are unnecessary.

RECOMMENDATIONS TO THE SECRETARY OF DEFENSE

We believe that, to insure the success of its efforts to improve the accountability for Government-furnished material, the task force should be instructed to:

- Develop procedures within the Air Force accounting system that establish an audit trail for determining the amount of Government material given to contractors. This will permit comparisons between what Government activities report as furnished to contractors and what contractors report as received. In those instances where differences exist, reconciliations should be required.

- Design better consumption data to improve the evaluation of contractors' reported usage of Government material and identify excess material held by contractors.
- Provide this information to property administrators so they have independent data that can be used to pinpoint differences between the Government and contractors' records.
- Provide guidance to property administrators on the need for increased surveillance when the contractor is doing commercial and Government work at the same location.

Adoption of our recommendations is necessary to insure that the Air Force accounting system will provide the initial source of control for Government-furnished material as required by the accounting principles and standards of GAO and the Air Force.

AGENCY COMMENTS AND OUR EVALUATION

As mentioned above, DOD stated that action is being taken in property management as we recommended. (See app. I, p. 16.)

The Air Force also provided formal comments to our proposed report. (See app. I, pp. 17 and 18&) Discussions were held later with Air Force personnel to obtain further details on planned corrective action.

The Air Force plans to test an Automated Item Transaction Reporting System at five overhaul and repair contractors beginning May 1976. The system will be designed to provide Air Logistic Centers with a centralized record by national stock number, quantity, and dollar value for each item of Government-furnished material shipped to contractors. In addition, contractors will also be required to report to the centers the amount of Government-furnished material received, used, and excess. If the test is successful and cost effective, the Air Force plans to implement the system at major contractor plants accounting for about 90 percent of the Government material used. In addition to establishing a system that will provide an independent Government record, the Air Force plans to use data derived from this system to improve Government estimates of how much Government material contractors should use. The Air Force intends to provide this data to property administrators to assist them in their surveillance of contractors.

In the interim, the joint task force of DCAS and Air Force personnel is examining major overhaul and repair contractors to determine if there are ways to assist item managers furnishing Government material to the contractors.

CHAPTER 5

SCOPE OF REVIEW

We examined procedures and controls at four Air Logistics Centers to determine whether controls over Government-furnished material held by overhaul and repair contractors were adequate to monitor their performance and protect the Government's interest.

In addition to examining records, we had numerous interviews and briefings with the operating and management officials of the Air Force and Defense Contract Administration Services. The four Air Logistics Centers were:

ACC 0135
AGC 00553 - Oklahoma City, Oklahoma;
ACC 00565 - Ogden, Utah;
AGC 00454 - Sacramento, California; and
AGC 00113 - San Antonio, Texas.



ASSISTANT SECRETARY OF DEFENSE
WASHINGTON, D.C. 20301

INSTALLATIONS AND LOGISTICS

7 JUL 1975

Mr. R. W. Gutmann
Director, Procurement and
Systems Acquisition Division
U.S. General Accounting Office
Washington, D. C. 20548

Dear Mr. Gutmann:

This is in response to your letter of April 16, 1975 to the Secretary of Defense transmitting General Accounting Office draft report on, "Better Control Needed Over Government-furnished Material in the Hands of Contractors" (OSD Case #4072).

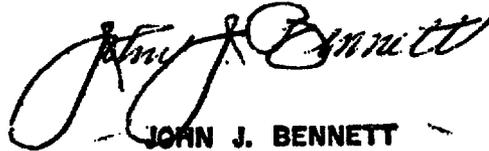
Your report involved Government-furnished property in the hands of Air Force overhaul and repair contractors and administered by the Defense Contract Administration Service (DCAS). The report finds that contractors maintain the records of such materials and also have physical control of these assets; that this practice constitutes a basic violation of internal control unless an independent means of assessing contractor performance is established. Your report further found that accountability for such Government-furnished materials in the Air Force includes incomplete estimates of materials to be used, limited visibility into materials ordered and received by contractors, and no check of whether materials are used for proper purposes.

You recommended that the Secretary of Defense direct a coordinated effort between Air Force and DCAS to develop information, guidance, procedures, and systems to overcome the alleged deficiencies.

Attached are pertinent comments on your report provided by the Air Force and DCAS. This office concurs with these comments, and

feels that the current efforts of Air Force and the Defense Supply Agency to improve the administration of contracts involving Government-furnished materials make it unnecessary for the Department of Defense to provide any additional direction to those agencies as contemplated by your recommendation.

Sincerely,



JOHN J. BENNETT
Acting Assistant Secretary of Defense
(Installations and Logistics)

Enclosures
a/s

COPY

DEFENSE SUPPLY AGENCY
Headquarters
Cameron Station
Alexandria, Virginia 22314

DCAS-AMP

22 MAY 1975

MEMORANDUM FOR ASSISTANT SECRETARY OF DEFENSE
(INSTALLATIONS AND LOGISTICS)

SUBJECT: Draft GAO Report, dated 16 April 1975, "Better Control Needed Over Government Furnished Material in the Hands of Contractors" (OSD Case #4072)

1. The following comments will address the specific recommendations in the report and also certain remarks and allegations which we feel should be commented upon.
2. The GAO report under its Findings and Conclusions on pages i and ii, had indicted the ASPR system and particularly, although without specific reference, the Military Standard Requisitioning and Issue Procedure (MILSTRIP) with statements like "materials ordered and received could only be checked against the contractors' records. Thus property administrators could not determine receipt of Government material unless the contract recorded the receipts." However, this ASPR system calls for copies of requisitions, receiving reports, stock record cards, and stock room issue slips, thereby providing an adequate audit trail to determine whether or not Government Furnished Material (GFM) has been received. While the ASPR system relies on the contractor's integrity, contractor implementation of the ASPR requirements does provide for internal controls among production personnel who requisition material, receiving personnel who inspect and record incoming shipments, and stock room personnel who maintain the inventories of material (stock record cards) and issue the material to the production lines. In addition, the contractor comptroller or financial accounting personnel maintain purchase orders and invoices for contractor-acquired material, thus providing an additional means of internal control. The ASPR Committee designed the property system to provide an automated and thus rapid response to contractors' legitimate requirements for GFM. One major benefit is a reduction in pipeline time. Another is reduction in amounts of Government material retained in contractors' stock as a reserve for emergency needs. The

DCAS-AMP

SUBJECT: Draft GAO Report, dated 16 April 1975, "Better Control Needed Over Government Furnished Material in the Hands of Contractors" (OSD Case #4072)

present system may not provide absolute assurance against losses or misuse of Government material. However, with its checks and balances and numerous surveillance activities and reviews made by property administrators, Contract Management Teams, Inspector General, Internal Auditor, and General Accounting Office provides reasonable property management in relation to the investment. The alternative is a return to an earlier system of having the contract administration office obtain and certify each requisition and receiving report that is issued. This system was abandoned by the Defense Department in 1951 as uneconomical and impractical.

3. A statement on page 6 is attributed to Defense Contract Administration Services officials that "Neither the physical observation of material used nor the determination of the reasonableness of such use are normal survey steps." In checking the source of this statement, it was found to be a misinterpretation of the actual situation. A primary objective of a property administrator is to determine whether the consumption of GFM is reasonable. This is specified in ASPR Supplement No. 3 - Property Administration - S3-402.3(k) which states "It shall be determined by both physical examination and analysis of records that quantities consumed are for proper purposes and in reasonable amounts." In addition, one of the 10 categories of property control examined by the property administrator is titled "Consumption. The process of incorporating Government-owned property into an end item or otherwise consuming it in performance of a contract." A major characteristic tested is whether "Quantities consumed are reasonable when compared to bill of material, material requirement lists, established scrap rates, etc." Reasonableness of consumption of GFM can, in an ordinary production contract, be determined by multiplying the unit allowance of the GFM by the number of end items delivered to the Government. In overhaul and repair contracts such precise computations are not possible because each end item, i.e., the item to be repaired, may require different quantities and different kinds of material. Therefore, the only means of determining the reasonableness of consumption of GFM is to compare usage against each bill of material, job order, or against a constantly revised material requirement list (MRL).

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STBJECT: Draft GAO Report, dated 16 April 1975, "Better Control Needed Over Government Furnished Material in the Hands of Contractors" (OSD Case #4072)

4. The draft report states on page 8 that "Accountability of GFM therefore is dependent upon part time property administrators and the integrity of the contractors and their employees." This statement is correct. It is the essence of the ASPR system to review the contractor's system and, if acceptable, rely on the contractor's integrity and periodic surveys by Government personnel to determine whether the contractor is adhering to the approved system. Hence, the question is raised whether the GAO is suggesting the rescission of the ASPR Section XIII, Appendix B, and Supplement No. 3, and the substitution of a system of having a Government accountable property officer receive copies of every document covering every transaction in every contract and maintaining the official records for all Government-owned property.

5. Both the Air Force and DSA have been aware of the difficulties inherent in the management of GFM under repair and overhaul contracts as cited in the GAO draft report. Accordingly, a GFM Task Group was established at AFLC headquarters on 11 July 1974 to study the problems and effect remedial actions. DSA is represented on this task group. One of the tasks assigned to the GFM Task Group is to establish an automated contractor reporting system which will provide the ALCs item visibility by National Stock Number over GFM inventories, requisitions, and consumption. Such a system has been designed and approved by OMB for service testing. It is anticipated the service test will be accomplished with one or more contractors beginning on or about 1 July 1975. If the results of the service test are favorable, the system will be expanded to include other major maintenance contractors. It will not only provide item visibility over GFM in contractors' possession, but usage data to develop more realistic MRLs. This task addresses itself to the first, second, and third of the subject report recommendations.

6. The fourth recommendation states that additional guidance to property administrators be provided "..... when the contractor is performing commercial and Government work at the same location." Two of the fundamental requirements imposed upon the contractors and monitored by property administrators are that "Government property is segregated

DCAS-AMP

SUBJECT: Draft GAO Report, dated 16 April 1975, "Better Control Needed Over Government Furnished Material in the Hands of Contractors" (OSD Case #4072)

from contractor property" (ASPS No. 3, Annex I, Category 4a(2)), and that the "Item be used for purpose for which authorized (not diverted to other use)" (ASPS No. 3, Annex I, Category 6b(1)). This is a part of the contractors' procedures which are analyzed prior to approval by the property administrator and part of the system surveys conducted to determine the contractors' adherence to the approved procedures. Unauthorized commingling of Government with contractor property can result in withdrawal of approval of the system and a finding of liability against the offending contractor. (ASPR 13-108).

7. The fifth recommendation to "conduct periodic evaluations of the Property Administrators' reviews of contractors' property accounting system.." is presently being performed. Currently, a property administrator's work is reviewed by (a) his supervisors, (b) the region staff, (c) the Contract Administration Property Review Board, (d) DSA CAS staff, (e) Contract Management Review Teams, (f) Inspector General, (g) Internal Auditor, and (h) the GAO.

8. As evidenced by the establishment of the GFM Task Group cited above, the Air Force and DSA are aware of the property conditions existing in overhaul and repair contracts. Action is being taken in the property management and supply disciplines as recommended by the GAO to increase emphasis on contractors' material control systems and property administration techniques.

P. F. COSGROVE, Jr.
Rear Admiral, SC, USN
Deputy Director

COPY

DEPARTMENT OF THE AIR FORCE
Washington 20330

Office of the Assistant Secretary

22 MAY 1975

MEMORANDUM FOR THE ASSISTANT SECRETARY OF DEFENSE
(INSTALLATIONS AND LOGISTICS) AE

SUBJECT: GAO Draft Report, dated April 16, 1975, "Better Control Needed Over Government Furnished Material in the Hands of Contractors" (OSD Case #4072)

The Air Force has been requested to provide comments to your office on the subject report.

The Air Force is in general agreement with the GAO that improvements are necessary in the management of Government furnished material (GFM) in the possession of Air Force overhaul and maintenance contractors. This subject has received intensive interest during the past few years and, while significant problems remain, progress has been made in eliminating deficiencies such as those described by the GAO.

In 1968, with the advent of industrial funding of Air Force Logistics Command (AFLC) depot maintenance contracts, AFLC attained increased visibility over the amount of GFM in the hands of overhaul and maintenance contractors. It became evident that inventories of GFM were far in excess of those authorized by contractual provisions, and as a result of efforts during the past few years the inventories of GFM in contractors' plants have been reduced from approximately \$340 million to \$100 million. However, in recognition of continuing GFM problems, AFLC and the Defense Contract Administrative Services (DCAS) initiated a study of the issues in 1973 and AFLC subsequently developed a comprehensive corrective action program.

These actions offer effective solutions to the problems cited by the GAO. For example, the GAO stated that accountability for GFM within the Air Force typically includes incomplete estimates of materials to be used, limited visibility into materials ordered and received by contractors, and no check of whether materials are used for proper purposes. AFLC has developed and will soon test an

automated contractor reporting system which will provide the Air Logistics Centers (ALCs) item visibility by National Stock Number (NSN) over GFM inventories, requisitions and consumption. This system will not only provide item visibility over GFM in contractors' possession, but also usage data to develop valid and realistic material requirements lists (MRLs). This reporting system will correct deficiencies described in the GAO report.

While the deficiencies noted by the GAO are similar to those defined by the AFLC, the Air Force takes exception with several of the control characteristics the GAO considers necessary for proper GFM management. The report stressed the need for centralized, independent records to better manage GFM. The Air Force is searching for more efficient controls. The GAO also asserts that the reasonableness of GFM consumption should be determined from comparisons with estimates (material requirements lists (MRL)). We cannot agree because the MRL itself is derived from consumption histories. The GAO recommends furnishing independent data to property administrators upon which to evaluate contractors' performance. Although the Air Force agrees that the interface between the supply system's inventory control points and property administrators must be improved, we do not consider the generation of independent data via a single supply support control point concept as suggested by the GAO, to be the best approach. The current DoD policy calls for Government surveillance of contractor operations and records (with clear audit trails) to protect the Government's interests. The report also recommends that additional periodic evaluations of property administrators' reviews of contractors' property control systems are needed. Since various periodic reviews are currently made by AFLC and DCAS staff teams and by Auditor General and Inspector General review teams, we believe the current scope of evaluations is adequate.

MATERIAL DELETED--COMMENT NO LONGER RELEVANT.

RICHARD J. KEEGAN
Deputy Assistant Secretary
(Programs and Acquisition)

PRINCIPAL OFFICIALS OF THE DEPARTMENTS
OF DEFENSE AND AIR FORCE AND DEFENSE
SUPPLY AGENCY RESPONSIBLE FOR
ADMINISTERING ACTIVITIES
DISCUSSED IN THIS REPORT

		<u>Tenure of office</u>	
		<u>From</u>	<u>To</u>
<u>DEPARTMENT OF DEFENSE</u>			
SECRETARY OF DEFENSE:			
Donald H. Rumsfeld	Nov.	1975	Present
James R. Schlesinger	July	1973	Nov. 1975
William P. Clements (acting)	June	1973	July 1973
Elliot L. Richardson	Jan.	1973	May 1973
Melvin R. Laird	Jan.	1969	Jan. 1973
DEPUTY SECRETARY OF DEFENSE:			
William P. Clements	Jan.	1973	Present
Kenneth Rush	Feb.	1972	Jan. 1973
David Packard	Jan.	1969	Dec. 1971
ASSISTANT SECRETARY OF DEFENSE (INSTALLATIONS AND LOGISTICS):			
Dr. John J. Bennett (acting)	Apr.	1975	Present
Arthur I. Mendolia	Apr.	1973	Mar. 1975
Hugh McCullough (acting)	Jan.	1973	Apr. 1973
Barry J. Shillito	Feb.	1969	Jan. 1973
<u>DEPARTMENT OF THE AIR FORCE</u>			
SECRETARY OF THE AIR FORCE:			
James W. Plummer (acting)	Dec.	1975	Present
John L. McLucas	May	1973	Nov. 1975
Dr. Robert C. Seamans, Jr.	Jan.	1969	May 1973
ASSISTANT SECRETARY OF THE AIR FORCE (INSTALLATIONS AND LOGISTICS):			
Frank A. Shrontz	Oct.	1973	Present
Richard J. Keegan (acting)	Aug.	1973	Sept. 1973
Lewis E. Turner (acting)	Jan.	1973	Aug. 1973
Philip N. Whittaker	May	1969	Jan. 1973

<u>Tenure of office</u>	
<u>From</u>	<u>To</u>

DEFENSE SUPPLY AGENCY

DEPUTY DIRECTOR, CONTRACT ADMINIS-
TRATION SERVICES:

Maj. Gen. Henry Simon	Sept. 1974	Present
Maj. Gen. Joseph J. Cody, Jr.	Oct. 1971	Aug. 1974
Maj. Gen. Robert H. McCutcheon	July 1970	Sept. 1971

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